COUNCIL AGENDA: 11/18/14
ITEM: 4.5

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: **City Council**

FROM: Councilmember Rose Herrera

SUBJECT: **Housing Impact Fee**

DATE: November 17, 2014

APPROVE Rose Herrera **DATE** 11/17/2014

RECOMMENDATION:

Accept staff recommendation on the parameters of the Housing Impact Fee with the following changes:

1. Set the Housing Impact Fee (Fee) not to exceed $11 per square foot
2. Exempt developments smaller than 19 units from the Fee
3. Exempt 50% of the Fee for mixed-use developments that have a minimum Floor-Area Ratio (FAR) of 0.5 dedicated for commercial or retail use
4. Allow City staff to waive the Fee for a development if some percentage of the units were restricted to affordable rent by a recorded covenant enforceable by a government agency other than the City of San José
5. Collect the Fee at occupancy
6. For purposes of the Fee, do not include assisted living facilities as residences

BACKGROUND:

There is a housing crisis in the Silicon Valley. The Housing Impact Fee policy coming before council on November 18th is an attempt to address this crisis by giving another monetary tool to local policy makers. While I do not completely oppose this policy, I do have my reservations about the specifics with regard to both the path it will put our city on and the consequences of implementation. Hearing feedback from many concerned stakeholders I believe the currently recommended Fee level is set too high and instead should be set not to exceed $11 a square foot while we continue to examine the consequences over the first few years of implementation.

Beyond the Fee level I am concerned with the starting point for this policy, namely local developers. The Nexus study, the study required before council can legally implement an impact fee, started from market rate rental prices in San José. Notwithstanding the debate about the legality of the nexus study being justified to implement the Housing Impact Fee, I believe the study starts downstream from the beginning of a bigger, regional nexus. As staff has stated, market rate rents are determined by demand. This demand is created by the job growth within our region. By trying to craft a policy tool bound to a single city, and paid by a single industry we are ignoring the regional origins of the crisis.

We must do better at treating this as a regional issue when crafting new policy or reviewing the efficacy of implemented policy. Under the current revenue structure of our region San José cannot fiscally continue to mitigate the housing externalities created by jobs if we do not have access to the money these jobs generate. The tools we create as a region cannot continue to ignore this. Moving forward I hope we can convene as a County and discuss ways in which this problem can be tackled comprehensively, not just city by city.

My second concern is the unintended consequences resulting from the implementation of this policy, especially with regard to total housing supply growth. The economic realities of a market are what dictates developers' choices on how to move forward with a project. Whether they choose to build or not, build small or large units, mixed-use or just residential is all determined by which design can attract enough tenants, and paying enough for rent to cover costs and upkeep. By reducing the profit potential there is a chance that certain developments will no longer be feasible thus reducing the net supply of future housing. This means less people will have a space to live, regardless of income.

Specific examples of this can be seen in mixed-use and small in-fill housing developments. Under our current system, mixed-use buildings, are very difficult to finance in a way that will allow for development profitability. These type of developments are critical to moving ahead with our Urban Villages plan. Similarly small in-fill developments under 19 units are typically more difficult and costly to develop and lack the efficiencies of economies of scale, and thus have trouble amortizing the Fee like bigger developments can. While the feasibility study assured that the San José rental market as a whole can absorb the Fee's impact through downward pressure on land prices, a breakdown of the market shows that specific sectors of the market, such as mixed-use and in-fill developments, will likely not see enough downward pressure to keep their original plan profitable.

Units from these type of developments are not guaranteed to be absorbed by other types of developments within our city and we lose the desperately needed jobs that such a project would have added both during and after construction. This would put our city in a worse position to deliver the services that we need to provide our residents. We need to increase our housing supply as a region, and we must increase our number of jobs as a city. It is counter intuitive to put developments that may provide both or either in peril.

More than just mixed-use we must also examine the timeline for building these affordable units. By tying affordable housing to the city through necessarily separate funds, administration, and developments without the option of including it in market rate developments, this policy will lead to an affordable housing development that is open to tenants long after the nexus is created. With an eye on the Palmer decision, we need to leverage any tool we have as a city to encourage the building of affordable units here and now. Should a developer see a cheaper opening for affordable units in a market rate development then we need to provide them an opportunity to act on it within the constraints of this policy.

I am proposing both exemptions and incentives in order that the implementation of a Housing Impact Fee does not halt smaller planned developments, put the feasibility of Urban Villages in danger, or unduly prolong the building of affordable units.